



William A. Bonnet
Vice President
Government and Community Affairs

May 5, 2005

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PUBLIC UTILITIES
COMMISSION

The Honorable Chairman and Members of the
Hawaii Public Utilities Commission
465 South King Street, First Floor
Kekuanaoa Building
Honolulu, Hawaii 96813

Dear Commissioners:

Subject: Docket No. 03-0372
Competitive Bidding for New Generation

This is to inform the Commission that Hawaiian Electric Company, Inc., Maui Electric Company, Limited and Hawaii Electric Light Company, Inc. have discovered an error in its response to HREA-HECO-IR-8, filed April 28, 2005, in the subject proceeding. Page 5 of the response was inadvertently omitted. A replacement response is attached.

Sincerely,

Attachment

cc: Division of Consumer Advocacy
K. Morihara, Esq./M. Lau, Esq.
G. Aoki, Esq.
G. Gilman
C. Young, Esq.
W. Bollmeier II
R. Reed
C. Colman, Esq.
T. Gorak, Esq.
L. Nakazawa, Esq.

H. Achenbach
S. Golden
B. Moto, Esq.
K. Kobayashi
J. Crouch
S.A. Wong, Esq.
M. de'Marsi
G. Bull
G. Sato

Revised 5/5/05

HREA-HECO-IR-8

On page 8, HECO first introduces the issue of the company's debt/equity ratio and potential impacts if additional purchase power is acquired.

See also HREA-HECO-IRs-9, 26, and 27. Please clarify:

1. Do HECO's concerns apply primarily to interest rates on bonds for new generation, or also to other types of debt financing?
2. Is there a recognized or verifiable relationship between the amounts (percentages) of purchase power to a specific credit "downgrading" that HECO suggests would occur if there were additional purchase power were incurred? Please provide quantitative examples.
3. Please provide the amounts/percentages of the various types of financing employed by HECO (Oahu only) over the past 10 years?
4. Therefore, does the potential "downgrading" affect HECO's financing of generation assets the same as T&D assets? Please explain.
5. What would be the anticipated impacts if HECO did not make the next generation investments on Oahu? Specifically, what would be the increased interest costs as a percentage of monies invested?
6. Given an IPP provides the next increment on Oahu (item 5), would there be an impact on the next round of T&D investments by HECO? Specifically, what would be the increased interest costs as a percentage of monies invested?

HECO Response:

1. As discussed in greater detail in HECO's SOP, Exhibit A, page 24, in this proceeding, and extensively in HECO T-21 in Docket No. 04-0113, long-term, fixed payments in purchase power contracts impact a company's debt/equity ratio. Currently, HECO's purchase power contracts impact the debt/equity ratio as a result of debt being imputed by credit rating agencies; however, as a result of changes in accounting standards, HECO's accounting treatment may change. The changes in accounting standards may result in more actual debt being shown on HECO's financial statements as a result of either: 1) capital lease treatment or 2) consolidation of an IPP which is more highly

leveraged than HECO. A company's debt/equity ratio is one of many considerations in evaluating its overall credit quality. Credit quality impacts the cost of all the

Company's sources of future financing including any new debt issuances. Debt/equity ratio is also a measure of risk to shareholders. Higher debt is more risky; therefore, a higher debt/equity ratio will increase return expectations for equity. See also response to (4).

2. Credit rating agencies do not quantify relationships that directly translate to credit ratings; however, general guidelines are provided and are considered along with other non-qualitative factors. The Standards & Poors' ("S&P") article "New Business Profile Scores Assigned for U.S. Utility and Power Companies; Financial Guidelines Revised" discusses indicative credit ratings for three key financial ratios: 1) funds from operations/interest coverage, 2) funds from operations/total debt, and 3) total debt/total equity. (See the response to CA-HECO-IR-19 for a copy of the S&P report.) As discussed in response to CA-HECO-IR-19, S&P imputes debt and interest expense for the Companies' existing firm capacity long-term contracts. Imputed interest lowers the funds from operations/interest coverage ratio, which lowers the indicative credit rating for this ratio. Imputed debt lowers the funds from operations/total debt ratio, which lowers the indicative credit rating of this ratio. Imputed debt increases the total debt/total capital ratio which lowers the indicative credit rating of this ratio. Overall, this has a negative impact on the credit rating indication from this quantitative portion of their overall credit evaluation.

In response to the impacts of imputed debt, HECO has decreased its other (actual) debts and increased its equity to maintain the debt/equity ratio.

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3. HECO (Oahu only) capitalization is shown on attached page ~~4~~⁵. Short-term borrowings have been comprised of commercial paper issuances and intercompany borrowings from subsidiaries. Long-term debt has been comprised of special purpose revenue bonds, first mortgage bonds and unsecured notes. Hybrids are comprised of quarterly income preferred securities.
4. HECO does not plan specific financing for individual projects or types of assets (such as generation or transmission and distribution assets). Financing is planned for the Company's total needs, targeting certain proportions of debt and equity in the capital structure. A credit rating downgrade would have a negative effect on the cost of future financing for HECO.
5. HECO cannot speculate as to the impact of not building the next generating units. The impact is dependent upon what happens in the alternative. There will be significant impact on the Company's operations and ability to serve load, as discussed in Exhibit A. The impact of HECO not building the next generating unit extends far beyond the financial impacts. The credit impact of a purchase power contract is dependent on the specific terms of the contract. In general, more risks (e.g., long terms, fixed payments) being assumed by the purchaser will result in more negative impact on its credit and higher financing costs as a result.
6. As discussed in (5), HECO cannot speculate as to the impact of purchasing power since it is dependent on the specific terms of the contract; however, if a purchase power contract causes HECO to be more leveraged (i.e., have more debt on its balance sheet or having credit rating agencies impute debt), HECO would propose to rebalance its capital structure (i.e., reduce other debt and increase equity). Such rebalancing will

result in a capital structure that has the same debt and equity ratios as before the purchase power contract which should account for the financial implications of the purchase power contract. As a result, other financings should not be negatively impacted. There will, however, be a cost to ratepayers resulting from more equity financing and less debt financing. Since equity is relatively higher cost than debt financing, this will result in higher costs to ratepayers. Alternatively, if HECO does not rebalance its capital structure, the increased riskiness of its financial structure will result in higher costs of both debt and equity financing since investors will expect higher returns due to the increased risks they are taking.

HAWAIIAN ELECTRIC COMPANY INC. (Oahu Only)

CAPITAL STRUCTURE

DECEMBER 31

(\$ in thousands)

Balances per books

	2004	2003	2002	2001	2000	1999	1998	1997	1996	1995
CAPITALIZATION BALANCES (\$)										
SHORT-TERM BORROWINGS	61,460	20,700	13,700	42,697	91,362	89,213	114,214	61,781	66,296	76,053
LONG-TERM DEBT	436,503	434,824	432,597	407,676	390,218	369,018	347,395	369,279	368,437	335,896
HYBRIDS	30,000	60,000	60,000	60,000	60,000	60,000	60,000	30,000	0	0
PREFERRED STOCK	22,293	22,293	22,293	22,293	22,293	22,293	50,893	53,293	55,693	58,093
COMMON EQUITY	640,892	582,562	570,480	539,060	494,295	482,549	471,897	474,346	460,526	433,518
TOTAL CAPITALIZATION	1,191,148	1,120,379	1,099,070	1,071,726	1,058,168	1,023,073	1,044,399	988,699	950,953	903,559

CAPITALIZATION RATIOS (%):

SHORT-TERM BORROWINGS	5.16	1.85	1.25	3.98	8.63	8.72	10.94	6.25	6.97	8.42
LONG-TERM DEBT	36.65	38.81	39.36	38.04	36.88	36.07	33.26	37.35	38.74	37.17
HYBRIDS	2.52	5.36	5.46	5.60	5.67	5.86	5.74	3.03	0.00	0.00
PREFERRED STOCK	1.87	1.99	2.03	2.08	2.11	2.18	4.87	5.39	5.86	6.43
COMMON EQUITY	53.80	52.00	51.91	50.30	46.71	47.17	45.18	47.98	48.43	47.98
TOTAL	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00

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